

POOLING AND REINSURANCE IN WASHINGTON STATE HEALTH INSURANCE MARKETS:

Review of the OIC Proposal

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Introduction

Washington State's health insurance markets work well for many groups and individuals in the state. However, both the high level and volatility of premiums create barriers for smaller groups, mid-sized employers, and individuals seeking private insurance coverage. If the sources of high and volatile premiums are not addressed, these entities may fail to purchase private coverage or may drop existing coverage, resulting in increased pressure on public insurance programs, increased uninsurance, and/or increased uncompensated care.

The Office of the Insurance Commissioner (OIC) developed a proposal for a reinsurance program to address these issues. OIC's work was motivated by the empirical observation of both rapidly rising and highly volatile premiums in both the small group and individual markets. The volatility of the insurance market, particularly for smaller groups, is related to the distribution of very high cost individuals. While the numbers of these high cost individuals is relatively small, they can have large effect on claims in the market and therefore on premiums.

Washington, like many other states, has tried to deal with the impact of high cost individuals through various programs and regulations. However, their impact persists despite the existence of the high risk pool as a complement to the individual market and mandatory community rating in the small group market. Many states, facing similar market dilemmas, are exploring various forms of reinsurance as a means of enhancing the functioning of their insurance markets. OIC's model of reinsurance was informed by the experience of other states and supported by extensive empirical work conducted by OIC staff in 2004.

In early 2005, a team of experts from the University of Washington, Harvard University, Mathematica Policy Research, and Mercer Consulting Group was asked to review OIC's model. The review was funded jointly by the Commonwealth Fund (New York) and the OIC. This paper presents a summary of that review, and recommendations from the review team.

OIC Proposal: Strengths

The OIC proposal has many strengths.

- The empirical work includes analyses of the overall insurance market. Comparisons between the various sub-markets (e.g., individual, small group, and large group) are made to demonstrate the impact of pooling on claims experience within each sub-market.
- The proposal creates a pooling arrangement that is supported through assessments on private insurers rather than requiring public subsidies.
- The pool does not require insurers to anticipate high-risk enrollees; rather, the expenses of high risk enrollees above \$25,000 automatically go into the pool.
- The proposal does not require individuals who become high risk to change insurance arrangements or providers.
- Because the risk above \$25,000 continues to be shared by the insurance carrier, incentives to control high risk expenditures, while diluted by pooling, are not eliminated.
- The mandatory nature of the pool creates more stability than a voluntary pooling structure.
- The pooling of high risk individuals through reinsurance might tilt competition in insurance markets toward characteristics of higher value to purchasers such as network composition rather than numbers of high risk enrollees.

OIC Proposal: Weaknesses

The review team had some reservations about the OIC analysis and proposal.

- The empirical work focused on savings in administrative costs and lower premiums resulting from increased competition. The review team was not convinced that the empirical evidence conclusively supported either source of savings, and thought that more analysis was needed.
- The OIC also projected savings from lower reserves. Even if lower claims risk did result in lower reserve requirements, it is not clear that insurance carriers would actually hold fewer reserves and/or that these savings would be passed on to consumers in the form of reduced premiums.
- Competition in Washington insurance markets is already relatively intense, even if there are not many players. Increased competition that results from lower reserve requirements might come in the form of less well capitalized, and therefore less stable, companies. This is not necessarily a benefit.

- There are many forms of reinsurance. The OIC proposed one form of reinsurance; other options should be considered as well.
- The OIC chose not to include Washington's high risk pool (for the individual market) within the proposed pool.
- The real driver of insurance premiums is the high cost of care of high risk individuals. While the OIC proposal seeks ways to redistribute these costs, it is not clear how it would work to reduce them.
- Overall, the review team thought the OIC proposal was premature given its singular focus on reducing administrative costs and the lack of strength of the empirical evidence of its impact.

Recommendations

The review team thought there was much potential in pursuing a pooling and reinsurance approach to dealing with the level and volatility of premiums in private insurance markets in Washington. The review team made a number of specific recommendations.

- The legislature should form a commission with the objective of designing a pooling strategy that both redistributes the costs of high risk individuals and reduces cost through the use of care management strategies that focus on quality improvement as well as expenditure reduction.
- The commission membership should be broad based and include representatives of the major stakeholder groups around this issue: consumers, small employers, mid-sized employers, insurance carriers, unions, providers, the OIC, and legislators.
- The commission should have strong sponsorship from the Governor and Insurance Commissioner and strong independent leadership.
- The commission should engage in additional analysis of the impact of various pooling and reinsurance strategies on insurance submarkets, including the individual market, the small group market; as well as on mid-sized employers within the large group market.
- The commission should consider a wide range of possibilities, including alternative roles for Washington's high risk pool.
- The commission should consider strategies that require public subsidies as well as those that do not.
- Because the issue underlying rising insurance premiums is the rising cost of treating seriously ill individuals, the commission should consider ways to create incentives to implement advances in care management. The commission should seek input from groups, such as the Puget Sound Health Alliance, that are exploring this area.
- The commission should inform its work with the experience of other states' activities with regard to reinsurance.

- The commission should be given a reasonable timeframe within which to recommend a specific approach to distributing the costs of high risk individuals and encouraging better care management.

Conclusions

Overall, the review team believes that pooling and reinsurance have good potential to reduce the volatility of private insurance premiums in the small group and individual markets. However, the greatest potential for stabilizing the level of premiums while improving patient outcomes will come from better strategies for managing the care of high risk individuals. The OIC has provided a very good foundation upon which to build.